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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 84

SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN,

Petitioners,

against

AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act,

Respondents.

RESPONDENTS' REPLY BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

WEINSTEIN & LEVINSON,
Attorneys for Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins, answering majority stockholders, and Agatha L. Moore, answering creditor, Respondents.

BAAR, BENNETT & FULLEN,
Attorneys for J. P. Linahan, Inc., Debtor, Respondent.

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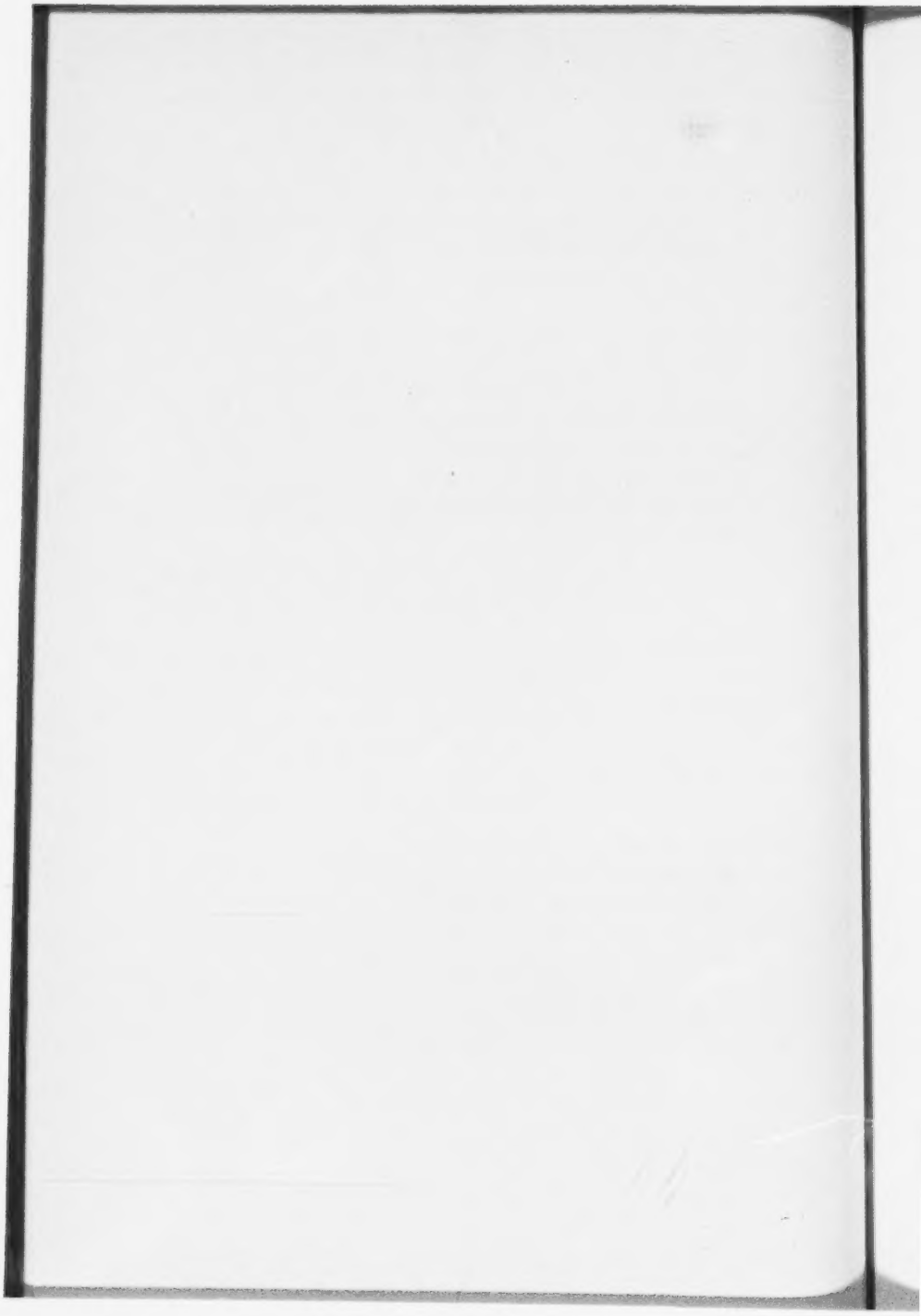

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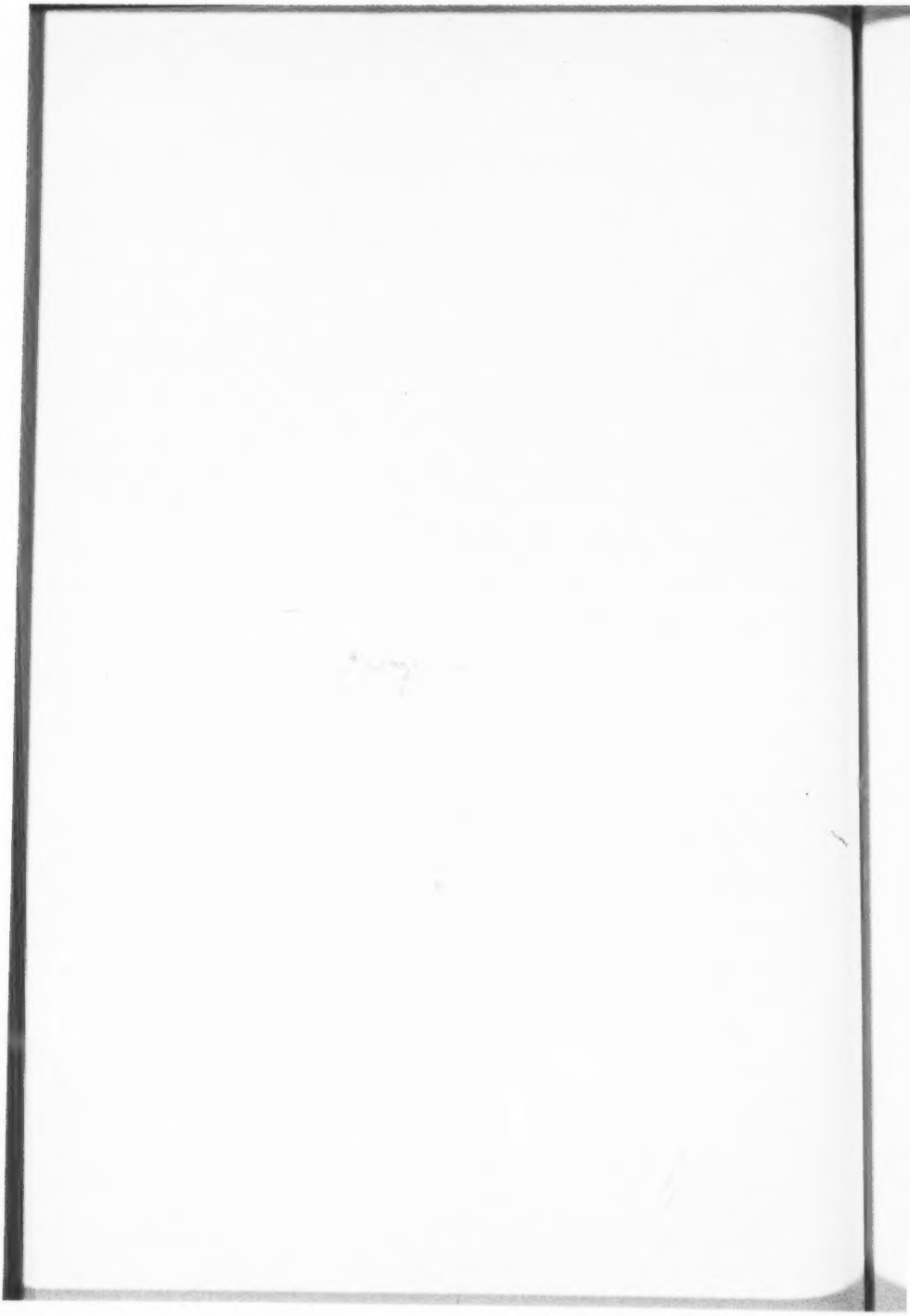

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SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN, Petitioners, against AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act, Respondents.	No.

RESPONDENTS' REPLY BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

Petitioners' reply brief contains inaccurate statements, and untenable and misleading contentions.

On page 2, petitioners state that

> "* * * the Circuit Court made it clear in its opinion, that it felt constrained to permit the withdrawal of the debtor's answer as a matter of right, although recognizing that such a holding resulted in a subordination of substance to form (Tr. 724")."

This statement is without warrant. The learned Circuit Court reversed the order confirming the Referee's report

approving the Chapter X reorganization petition, and granted leave to the debtor to file a new answer, so that the debtor may controvert the allegations of the petition (particularly the alleged commission of an act of bankruptcy) and seek dismissal of the petition. The learned Circuit Court rejected the untenable and technical contentions of the petitioners that the court lacked power to permit the debtor to withdraw its original answer and to contest Chapter X reorganization. The court below recognized that substantial justice plainly required that the new board of directors be permitted to undo the fraud of the old board in collusively consenting, on their very last day in office, to a Chapter X reorganzation that sought to eliminate the substantial equity of the stockholders of an amply solvent corporation, with full knowledge that the majority stockholders intended, on the next day, to elect new directors opposed to any reorganization under Chapter X that sought elimination of the equity of the stockholders and in favor of a fair arrangement under Chapter XI. The court below also recognized that the original fraud of the old board was accentuated by the subsequent illegal attempt of the petitioners to prevent any undoing of the fraud. For the petitioners applied for and procured from the reorganization court an injunction which permanently restrained the election of new directors and thereby prevented the election of a new board who, under Rule 15 (a) of the Federal Rules of Civil Procedure, would have had an absolute right to amend the debtor's answer so as to contest the petition and controvert its allegations. The injunction was reversed on appeal by the Circuit Court (*In re J. P. Linahan & Co.*, 111 F. 2nd 590). The fraud of the old board and their collusion with the petitioners (including the minority stockholder, Anna Louise Linahan, who has in bad faith instigated and used this Chapter X proceeding in an effort to force settlement of outside litigation and

controversies between herself and the majority stockholders, and whose counsel, Mr. H. I. Trachman, has acted as chief counsel for the petitioners in all of the proceedings herein), are so apparent that the Circuit Court writes that "the directors of the debtor probably knew in advance of this proceeding, and possibly they inspired it", and further writes:

> "Be that as it may, we need not too much regret it even if in this instance form may prevail, because, although directors, so long as they hold office and use an honest judgment, are immune from the control of their shareholders, *People ex rel. Manice* v. *Powell*, 201 N. Y. 194, 200, 201, 94 N. E. 634, the power to commit a corporation one day before they knew they are to be displaced, to a course known to be disapproved by the majority is not one to be generously extended. Normally the shareholders should have their way."

The reference made by the learned court below to form and substance, was not that, in this case, form prevailed over substance, but that the construction of Section 59, subdivision (g) of the Bankruptcy Act urged herein by the petitioners might lead to such a result. The court below noted that, even if the petitioners' contention, that Section 59, subdivision (g) precludes withdrawal of a debtor's answer without notice to all creditors, were to be assumed correct, such notice would not have permitted any creditor to object to withdrawal of the answer, since no creditor was prejudiced by reliance on the answer. The learned Circuit Court cites the decision of the Circuit Court of Appeals, Seventh Circuit, in the case of *In re Thorpe*, 12 F. 2nd 775, as holding that the right to withdraw a petition can be defeated only by proof that a creditor has relied on the petition to his detriment. But, as

the court below also notes, a rule contrary to that enunciated in the *Thorpe* case appears to have been followed in several District Court decisions (*In re Sullivan*, 23 F. Supp. 112; *In re Epstein*, 12 F. Supp. 450; *In re Browne*, 30 F. Supp. 157), in which, apparently, reliance and detriment were not deemed essential to denial of leave to withdraw a debtor's petition. It is only if the decision of the District Courts, rather than that of the Circuit Court in the *Thorpe* case, be followed, and if Section 59, subdivision (g), be construed as permitting a creditor to defeat withdrawal of a debtor's petition, even though no prejudice has resulted to the creditor, that the possibility of form yielding to substance might exist, since Section 59, subdivision (g), by its express terms, applies only to a debtor's petition, and not to a debtor's answer. Restricting the right to withdraw a debtor's petition without similarly restricting the right to withdraw a debtor's answer, furnishes no basis for reading the restriction into the answer, where the statute expressly and unambiguously limits the restriction to a petition. Section 59, subdivision (g), clearly applies only to a petition, and not to an answer.

On page 2, petitioners refer to the fact that the Circuit Court dismissed as moot respondents' appeal from the District Court's order of July 5, 1940, and argue that such dismissal indicates that the Circuit Court granted leave to the debtor to file a new answer, not as a matter of discretion, but as a matter of absolute right. But the appeal from the order of July 5, 1940, was made moot because the order confirming the Referee's report approving the petition for reorganization was reversed and leave was granted to the debtor to file a new answer, and the case was sent back to the District Court for retrial upon the new issues to be raised by the new answer. The granting of leave to file such new answer rested in sound judicial discretion, and was necessary in order to pre-

vent the gross fraud upon the majority stockholders that the petitioners (particularly the minority stockholder) were seeking to perpetrate.

In the last two paragraphs on page 2 of their reply brief, petitioners refer to their objection in the courts below to the filing of a new answer. But the petitioners, in the lower courts, made no claim that Rule 15 (a) does not apply to bankruptcy or reorganizations. Such claim is made by them now in this Court for the first time.

As to the mootness of the petitioners' present resistance to the new answer, the debtor has in fact served and filed a new answer which specifically denies the alleged commission of an act of bankruptcy and which demands dismissal of the Chapter X petition. The proceedings relating to such new issues have been adjourned by the Referee upon the motion of the petitioners and over the vigorous objection of the respondents.

The statement on page 3 of petitioners' reply brief that Sections 24A, 24B and 24C of the Bankruptcy Act permit an appeal from the order here involved as a matter of right, is palpably unsound. The order now under consideration is not final, but is interlocutory. It is an order which reverses the order approving the reorganization petition, and remits the entire matter for retrial upon new issues to be raised by the new answer.

The comment from 18 N. Y. U. Law Quarterly Review, page 410, quoted on pages 4 to 6 of the petitioners' reply brief, does not criticize the decision of the Circuit Court herein. The suggesion is there made that, in this case, leave could have been granted to the debtor to withdraw its original answer and to file a new answer, and that it was not necessary to determine whether, in the absence of withdrawal, a debtor's answer consenting to Chapter X reorganization permits either the corporation or creditors or stockholders to raise any issue as to the commission of an alleged act of bankruptcy. The writer of the comment states at page 411:

> "It is not at all clear, however, that adherence to the 77B cases would have demanded the conclusion that a consenting answer is so exact an equivalent of a voluntary petition as to prevent a withdrawal of the answer except upon terms applicable to petitions."

Indeed, the writer concedes:

> "But other issues—such as insolvency, need for reorganization, or good faith—must naturally remain open to attack by any party in interest as a protection against proceedings collusively or fraudulently instituted."

The debtor's amended answer, among other things, raises these very issues of insolvency, need for reorganization, and good faith, "as a protection against proceedings collusively or fraudulently instituted".

Respectfully submitted,

WEINSTEIN & LEVINSON,
Attorneys for Agatha L. Moore, Basil Moore, Margaret Wikstrom, Vincent Joyce and M. Harold Higgins, answering majority stockholders, and Agatha L. Moore, answering creditor, Respondents.

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